County of Los Angeles
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SACHI A. HAMAI
Chief Executive Officer

May 13, 2020

To: Supervisor Kathryn Barger, Chair
Supervisor Hilda L. Solis
Supervisor Mark Ridley-Thomas
Supervisor Sheila Kuehl
Supervisor Janice Hahn

From: Sachi A. Hamai
Chief Executive Officer

REPORT BACK ON HARD-HIRING FREEZE AND FREEZE ON NON-ESSENTIAL SERVICES, SUPPLIES AND EQUIPMENT PURCHASES (ITEM NO. 5, AGENDA OF MARCH 31, 2020)

As part of its March 31, 2020 motion by Supervisors Barger and Solis to implement a freeze on non-essential hiring and services and supplies, the Board requested that the Chief Executive Office (CEO) provide a written report on the financial impacts resulting from the coronavirus pandemic.

The coronavirus pandemic has created an unprecedented global health crisis and spurred a severe economic downturn. The fallout will result in broad and deep reductions in several of the County's key revenue sources, along with large increases in social and health-related expenditures.

Further, compared to the 2008 Great Recession, the County's revenue loss has been exacerbated by its greater reliance on sales tax revenues since the 2011 realignment of State programs to the counties. As part of the Fiscal Year (FY) 2011–12 budget plan, the State enacted a major shift or "realignment" of State program responsibilities and revenues to local governments. The realignment plan provides primarily State sales tax to counties to fund various criminal justice, mental health, and social services programs starting in FY 2011–12, and ongoing funds for these programs annually thereafter.

On May 7, 2020, the State Department of Finance announced that the State is facing an estimated $54.3 billion budget deficit, of which $13.4 billion in the current fiscal year and $40.9 billion for the next fiscal year.

Economic Analyses

My office regularly consults with economic experts, reviews media sources, and evaluates both internal and external data sources to estimate future County revenues, including sales tax-based revenues, property taxes, fee revenues, and others.

Recent analyses produced by our consultants forecasted a very sharp economic downturn in the second quarter of calendar year 2020, followed by a variable degree of economic recovery beginning in the third quarter of 2020. Some analysts forecasted a V-shaped recovery, with a possible return to pre-recession Gross Domestic Product levels as early as 2021. Other economic forecasts and media reports have been more pessimistic, foreseeing a longer period of economic difficulty and unemployment.

Due to the recency of this outbreak, available economic data remains very limited, while the spread of the COVID-19 disease remains uncertain. Unknown factors include the potential for future waves of infection, the impact of expected improvements to testing and contact tracing infrastructure and changes to social restrictions, new vaccinations and treatment discoveries, etc. As a result, any economic projections must be viewed as preliminary and subject to frequent change as new data becomes available.

FY 2019-20 Year End Close

For FY 2019-20, the County has already acted to curtail expenses via the hiring and purchasing freeze. Despite this action, we estimate that a sharp decrease primarily in sales tax and realignment revenues, along with additional COVID-19 costs, will result in an estimated shortfall of up to $1.3 billion as of June 30, 2020.

Unless additional resources are identified, we plan to close this deficit using a variety of approaches, including:

- As funding permits, departments will need to absorb expenses.
- Departmental trust funds and reserves will be used to offset expenses as appropriate.
- Countywide reserves (such as the Rainy-Day Fund) will be used as needed.

In June 2020, we plan to return to your Board with recommendations to realign the FY 2019-20 Budget as outlined above.

FY 2020-21 Recommended Budget

The Recommended Budget was prepared before the crisis emerged as a worldwide pandemic in March 2020. As such, the Recommended Budget does not reflect the estimated increased costs to respond to the crisis, nor the deep revenue losses that are resulting from it.

State and federal funding will offset a portion of the COVID-19 emergent expenditures during both FYs 2019-20 and 2020-21. However, County sales taxes and realignment revenues are reduced by a decreased level of economic activity.

The CEO will return to the Board in June 2020 with substantial revisions to the FY 2020-21 Recommended Budget, reflecting lowered revenue assumptions and significant cost curtailments.

For FY 2020-21, we are currently projecting a deficit of up to $1.2 billion. Unless additional revenues are identified, we will recommend a combination of cuts and other solutions to balance the County budget. These solutions may include:

- Continuing the freeze on non-essential hiring and purchasing.

- Eliminating or reducing new or expanded programs/projects identified in the Recommended Budget.

- Suspending County matching contributions for the 401(k) and 457 plans.

- Curtailing departmental programs by up to 20 percent of the net County cost contribution. Additional curtailments may be required for programs funded by 2011 State realignment sales tax revenues, such as law enforcement-related activities under Assembly Bill 109.

- Negotiating with our labor partners for greater flexibility to minimize layoffs and preserve public services to the extent possible.

- Using reserves or trust funds to defray program cuts, where they exist for specific programs.

Federal and State Emergency Funding

To date, the County has received a variety of restricted funding from federal and State sources. By far the largest source of restricted funding has come from the federal CARES

Act 3 legislation (H.R. 748), with $1.057 billion received by the County in late April 2020. This funding is restricted for new or unbudgeted COVID-19 health emergency-related expenditures and it must be spent by December 30, 2020.

Unless changes are made to the CARES Act 3 legislation, this funding cannot be used to backfill lost County revenues due to the economic crisis, which is a primary cause of the County's current budgetary concern. The funding remains in a trust account and can only be used to the extent that qualifying expenditures are made. We are now surveying departments to determine their projected expenditures through December 30, 2020.

Other, much smaller, sources of federal and State revenue have also been identified to support specific actions to respond to the COVID-19 crisis. Some funding sources, such as FEMA, generally pay only a portion of the federal share of cost up front. In such cases, the County incurs the full cost of the grant, but must wait a multi-year time period to recoup the remainder of the grant amount. Long FEMA grant repayment periods can create cash flow issues for State and local agencies, including the County.

Conclusion

The public health and economic crisis created by COVID-19 has resulted in a severe revenue loss to state and local governments, including the County. This unprecedented reduction is further complicated by the unknown duration of the crisis, and a lack of historical references to make educated budgetary projections.

Without assistance from the State and/or the federal government to offset the loss of revenue, the County will likely be forced to make painful cuts to criminal justice, public safety, social services, mental health, and other services.

My office will continue to closely monitor these matters, and update estimates as new data becomes available. We will continue to keep your Board informed.

If you have any questions or need additional information, please contact Matt McGloin of my staff at (213) 974-1694 or at mmcgloin@ceo.lacounty.gov.

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AS:KT:cg

c: Executive Office, Board of Supervisors
County Counsel